

**Before the
Federal Communications Commission**

In the Matter of:)	WC Docket No. 04-313
Final Unbundling Rules)	CC Docket No. 01-338

**Reply Statement of
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on Behalf of
Texas Office of Public Utility Counsel
and
The Consumer Federation of America**

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I. INTRODUCTION

My name is Mark Cooper. On behalf of the Texas Office of Public Utility Counsel (OPUC) and the Consumer Federation of America (CFA) I respectfully submit these reply comments in this proceeding.¹

The debate between the incumbent local exchange carriers (ILECs) and the competitive local exchange carriers (CLECs) in this proceeding parallels the debate that occurred at the state level.

The ILECs seek what is tantamount to a national finding of non-impairment and ignore the Court's call for granular analysis. To do so, they commit two fundamental errors.

- They ignore the cost of entry and barriers to serving residential customers from remote switches, claiming that any switch, anywhere in a metropolitan statistical area, can serve every customer, everywhere in that area.
- They refuse to recognize or fail to properly analyze the price and quality differences between services for local connectivity.²

The CLECs present substantial evidence that there are unique costs that present barriers to entry into many central offices and therefore result in impairment. However, they vastly overstate their case by claiming that any barrier, in any central office, for any CLEC must result in a finding of impairment.

- The cost analysis allows for no cost differential between incumbents and entrants and the competition analysis proceeds on a company-by-company basis, rather than a market-by-market basis.
- They continue to disregard intermodal competition.

¹ Unless otherwise noted, throughout these reply comments, I refer to the initial comments filed *In the Matter of Unbundled Access to Network Elements, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Federal Communications Commission, WC Docket No. 04-313, CC Docket No. 01-338, October 4, 2004.

² Initial Comments of BellSouth Corporation, Comments of the New York State Department of Public Service, count alternatives without analyzing their price.

In our initial comments OPUC/CFA proposed an approach that avoided these ILEC/CLEC pitfalls. These reply comments focus on the major flaws in these extreme approaches. The data filed in the initial round of comments in this proceeding reaffirms our belief that the definition of the relevant geographic market is the central office, with the product defined broadly as any CLEC lines served without using ILEC switching. The threshold for non-impairment should be five CLECs serving mass market customers without using ILEC switching and one CLEC serving 1% of the residential market served in that manner. Defined in this way, we find that clusters of central offices are not impaired, but the vast majority of central offices are impaired.

II. MISINTERPRETATIONS AND MISAPPLICATIONS OF THE IMPAIRMENT ANALYSIS

THE ILEC CLAIM OF WIDESPREAD NON-IMPAIRMENT IS BASED ON FAULTY ASSUMPTIONS

The ILECs' claim of widespread non-impairment is based on two fundamental assumptions that contradict the framework established by the D.C. Circuit. The ILECs simply reject economic analysis as a basis for determining impairment. This is true on both the demand-side and the supply-side.

Intermodal Competition for Demand

The ILECs now admit that circuit switched cable telephony is not widely available. Indeed, approximately 85 percent of the nation does not have this alternative available.³ We believe cable telephony should be counted where it is available.

³ UNE Fact Report 2004, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, p. 11.

Since cable telephony is not a ubiquitous competitor, the ILECs fall back on intermodal competition – VoIP and wireless – as the primary demand-side alternatives. However, in order to make the claim that these alternative services, which are widely available, are competitive, they demand that the Commission forego economic analysis of their substitutability for basic telephone service.

As BellSouth put it, “Nor should the Commission limit consideration of intermodal alternatives by comparing newer technologies against the cost, quality, and maturity of ILEC services. Doing so would be flatly contrary to the Commission’s pledge to adopt rules that reflect “current conditions in particular markets.”⁴ Failing to consider the cost and quality of products that are claimed to be alternatives would flatly violate the Court order to conduct economic analysis. For, as the Commission well knows, good substitutes are defined by the similarity of their price and quality characteristics.

Twisting the Commission’s commitment to provide granular analysis into a claim that price and quality should not be analyzed is a red flag that such an analysis would certainly show that the alternatives are not good substitutes.

Ironically, after BellSouth claims that the Commission should not examine the price and quality of the alleged competing services, it willy-nilly makes the claim that “the intermodal competition created by cable, VoIP, and wireless services demonstrates clearly that consumers are benefiting from increased choice and reduced prices without the need for unbundled switching from BellSouth.”⁵ This statement is categorically wrong, when it comes to price. In fact, VoIP and wireless are substantially more expensive than circuit switched telephony provided by ILECs and CLECs.

⁴ BellSouth, p. 12.

⁵ BellSouth, p. 26.

Exhibit 1 tells the basic story on price. VoIP is between two and four times as expensive as basic telephone service. It is between 30 percent and 90 percent more costly than the average monthly residential bill. Typical (median bills) tend to be even lower, so that VoIP is probably 50 to 100 percent more expensive than the typical bill. The high cost of VoIP stems from the fact that the consumer must have a broadband connection in addition to the telephone service. The broadband connection itself is substantially more expensive than basic telephone service. Moreover, three quarters of American households do not have broadband connections;⁶ forty percent do not even have the Internet.⁷ The VoIP service forces consumers to take a bundle of vertical services that is far larger than they typically purchase. Thus, for the vast majority of residential customers, VoIP is not a good substitute for telephone service.

Wireless is even more expensive than VoIP, when usage is considered. The vast majority of American households subscribe to flat rate service. The average level of usage is at least 1000 minutes per month outgoing and 1000 minutes for incoming.⁸ T-Mobile estimates total landline usage of over 2000 minutes per month.⁹ At that level of usage, wireless costs about \$100 per month, about twice the average wireline bill.¹⁰ If one wants to consider the lowest rate wireless plans, and no excess usage charges, the proper comparison would be to basic telephone service. In such a comparison, wireless is 60 percent more expensive.

⁶ UNE Fact Report, p. I-12.

⁷ Pew Internet and Life Project, February 2004.

⁸ Billy Jack Gregg, *A Survey of Unbundled Network Element Prices in the United States*, July 1, 2003, uses this assumption.

⁹ Comments of T-Mobil, p. 5.

¹⁰ Typical plans for 1,000 anytime, anywhere minutes and unlimited night and weekend minutes.

The fact that over 90 percent of all wireless subscribers reside in households that also have wireline service is testimony to the fact that these services are not substitutes.¹¹ Moreover, the fact that young people, who tend to be mobile and residentially transient, account for a disproportionate share of wireless subscribers who do not also have wireline service reinforces this observation.¹² They did not cut the cord; they never had one and are likely to get one when they settle down.

In short, the ILEC effort to end-run the granular analysis by invoking intermodal competition on the demand side does not stand up to basic economic analysis.

Supply-Side Provision of Circuit Switching

The ILEC argument on the supply-side does not fare any better. “That CLECs can readily use fewer switches and economically serve customers broadly dispersed throughout a large geographic area cannot be seriously disputed.”¹³

Unfortunately for this BellSouth claim, it presents no evidence to support the contention, while the CLECs have presented detailed analysis of the scope of the area that can be served. The ILECs mistake the technological possibility of using switches with the economic ability to do so.¹⁴

The CLECs’ analyses show that the geographic area is not wide and effectively dispute BellSouth’s unsubstantiated claim. Because of the need to collocate facilities in all central offices where residential customers are being served and transport traffic to the central switch, the reach of the switch is restricted.

¹¹ UNE Fact Report, II-29.

¹² *Id.*

¹³ BellSouth, p. 20.

¹⁴ *Id.*, p. 18.

The CLEC estimates of these costs show a “break-even” against the cost of UNE-switching in the range of 1000 to 3000 customers,¹⁵ depending on the assumptions used. In the smaller central offices, the prospects of achieving that scale are slim. Thus, there is a problem posed by economies of scale for new entrants.

CLEC CLAIMS OVERSTATE IMPAIRMENT

In some cases, the CLEC impairment analysis is based on the assumption that the CLECs break-even when the cost of replacing the switch is roughly equal to the cost of the switch as a UNE assuming only residential customers are served.¹⁶ In this analysis, at the break-even, the cost per line is about \$3.00 per month.¹⁷

CLECs also generally propose that the impairment analysis apply on a company-by-company basis. Each CLEC can order UNEs until it reaches the estimated size assumed to be necessary to overcome economies of scale.¹⁸

Neither of these approaches is consistent with the court’s interpretation of the statute.

The court asserted that start up costs might be higher for entrants. Moreover, switching is only a fifth of the total cost of service. Thus even a substantial cost difference for switching might not impair competition. As shown in our initial comments, the ability to mix enterprise and mass-market customers also enhances economic viability.

The court also required a market-by-market analysis, not a company-by-company analysis. By tying the impairment standard to individual companies, this approach fails to

¹⁵ Comments of the Michigan-Based CLEC Coalition, uses \$1,000. Comments of the Association for Local Telecommunications Services, et al. p. 97, uses \$1333. Comments of Dialog Telecommunications Inc., p. 5, estimates its break-even at 2,000 lines although it does not give details of how it arrived at this number.

¹⁶ Association for Local Telecommunications Services, et al., p. 98.

¹⁷ Declaration of Rainer Gawlick on Behalf of Lightship Telecom, p. 7

¹⁸ Association for Local Telecommunications Services, et al.; Comments of the National ALEC Association; Dialog Telecommunications, and Michigan-Based CLEC Coalition.

distinguish bad business plans or inefficient companies from impairment caused by economic market conditions. The CLEC proposal is tantamount to a rebuttable presumption that there is impairment. Presumably, the ILEC would seek to rebut the presumption by monitoring how many lines a CLEC had ordered with UNE-L. Similar proposals in the opposite direction are equally inappropriate. Thus, the ACS proposal for a rebuttable presumption of non-impairment should be rejected as well.¹⁹

III. ADDITIONAL EMPIRICAL SUPPORT FOR THE OPUC/CFA APPROACH

THE OPUC/CFA PROPOSAL AVOIDS THE ILEC AND CLEC MISTAKES

In our proposal we recommended a market-by-market analysis that decided impairment on the basis of markets, not individual companies. We set a threshold for non-impairment at 5 CLECs serving mass market customers without relying on ILEC switching, one of whom has reached a market share of 1% using that method of delivering service.

This avoids the problems in the CLEC proposal. Although we disagree with the CLEC approach, the empirical conclusion of our competition analysis is consistent with the CLEC economic analysis. We find non-impairment in many of the same central offices the CLEC approach would, although we apply that finding to all CLECs in the central office.

The number of mass-market lines in the central offices that we conclude are not impaired is around 25,000. However, the offices themselves are much larger, averaging between roughly 80,000 and 110,000 lines.²⁰ The average is about 100,000 total lines, 30,000 of which are mass market. The offices with 5 CLECs, none of which has achieved a 1%

¹⁹ Comments of ACS of Anchorage, Inc., p. 3.

²⁰ This includes enterprise voice equivalents.

market share, have 80,000 lines, of which about 39,000 are mass market. In contrast, the central offices we find impaired have about 18,000, of which 7,000 is mass market. We have set the standard lower than would be indicated by the CLEC economic analysis. Thus, implicitly at this threshold, the cost of switching is well above the UNE level.

Requiring that at least one, but only one, CLEC achieve a substantial scale as a condition of a non-impairment finding establishes the link between markets and non-impairment, rather than companies and non-impairment. The implicit assumption is that if one company can achieve a reasonable scale, the fate of the other companies is determined by their business skills, not market conditions.

Moreover, this analysis avoids the mistake of assuming that every switch used to serve enterprise customers can, or is, being used to serve mass market customers.²¹ No doubt some switches are used for both purposes and in our approach we count the ones that actually are.

Dialog offers an approach to non-impairment that has a practical effect that is similar to our approach.²² It recommends a line count approach. Central offices would not be impaired if they have more than 25,000 residential lines and more than 8,000 residential lines served by competitors. Dialog does not stipulate that the customers served by competitors must be served without relying on ILEC switches. Thus, it appears to fail to take into account the actual deployment of competitive switching. Since Dialog asserts that a break even for CLEC deployment of switching occurs at least 2000 lines,²³ it appears to be assuming that at the 8000 level of competition the central office would support three CLEC competitors who would transition to UNE-L. This meets the Commission's threshold in the TRO. Dialog also

²¹ Bell South, p. 16.

²² Dialog, p. 11.

²³ Dialog, p. 5.

recommends that if a CLEC falls below the threshold within 18 months of a finding of non-impairment, the finding of non-impairment would be reversed and the obligation to make UNE-switching available would be reinstated.

We have shown in our initial comments that the 25,000 residential line threshold is a good cut-off point, beyond which significant mass market competition is likely. Our competition threshold would be more than 1,000, but likely less than 5,000 mass market lines served by CLECs without relying on ILEC switching. There are likely to be many more lines served by UNE-P in such offices, so the offices considered non-impaired in our approach likely meets Dialog's second criteria as well.

The Michigan-Based CLEC Coalition uses the company-oriented approach. Based on its economic analysis, it recommends that individual CLECs be allowed to purchase UNE-switching until the CLEC achieved 10,000 lines in a LATA or 1,000 lines in a central office before there is a finding of non-impairment for that CLEC.²⁴ In this proposal, as in others, the availability of UNE-switching could be turned on if the penetration of the CLEC fell below the threshold. The Michigan-based CLEC coalition advocates a market (LATA)-wide analysis for wholesale switching. They argue that if two CLECs are making switching available on a wholesale basis, the entire market should be considered non-impaired for all CLECs.

Again, the orders of magnitude of competition indicated by this level of penetration are consistent with our earlier analysis. In the central offices OPUC/CFA proposed for a finding of non-impairment, the 1% threshold ranges, on average from 800 to 1100.

²⁴ Michigan-Based CLEC Coalition, pp. 5-6.

While it is reassuring to find that different approaches identify similar offices as candidates for a finding of non-impairment, particularly where one is based on cost assumptions, we believe the direct analysis of competition is critical to a rule that will withstand scrutiny. Thus, the economic analysis is consistent with and provides the conceptual underpinning for the empirical analysis of competition.

DATA ON COMPETITION

The data on the current extent of competition provided in numerous comments reinforces our belief that the approach we recommended is the correct approach. Details on the characteristics and the extent of competition in central offices in a number of states show that the pattern we observe in Texas occurs throughout the nation.

Although the proprietary nature of much of the data and somewhat different approaches used in the state proceedings makes comparisons difficult Exhibit MNCR-2 shows key pieces of evidence that can be gleaned from four large states – California, Ohio, New York and Texas. These states represent almost one-third of the lines in the country. They are also in the top half of the nation in terms of the extent of competition.

The pattern of deployment of CLEC switching in Texas that we described in our initial comments appears to be replicated in these other states. A large percentage of the central offices have little CLEC self-supplied switching. The majority of central offices do not meet the minimal three-CLEC threshold, even loosely interpreted, that the TRO set out. A rigorous approach to the definition of qualifying CLECs, or our five CLEC proposal, shows that less than a fifth of the central offices exhibit significant competitive deployment of switching.

In addition to these four states where quantitative analysis is possible, the record contains qualitative descriptions of three other states – New Jersey,²⁵ Kansas,²⁶ and Utah²⁷ – that appear to be similarly situated. These three are also well up in the top half of the nation in terms of the extent of CLEC competition. Thus, we conclude that many central offices are impaired throughout the nation and that the situation we described in Texas is not atypical. The analytic framework proposed will be an effective tool for conducting the granular analysis that the Court required.

The record evidence also shows that the metropolitan Statistical Area is far too large as a definition of the geographic market for switching. The economic evidence discussed above demonstrates that to be the case and many state Commissions or their staffs had been persuaded to use a much smaller geographic area. The most frequent conclusion was the wire centers are the appropriate market, including Michigan,²⁸ Utah,²⁹ California,³⁰ and New York,³¹ while others suggested exchanges, as in Missouri³² or clusters of wire centers, as in Kansas³³ and Ohio.³⁴

²⁵ Comments of the New Jersey Division of Ratepayer Advocate.

²⁶ Comments of the State Corporation Commission of the State of Kansas.

²⁷ Comments of the Utah Committee of Consumer Services; Comments of the Utah Division of Public Utilities.

²⁸ Initial Comments and Waiver Request of the Michigan Public Service Commission, p. 5.

²⁹ Comments of the Utah Division of Public Utilities, p. 6.

³⁰ Comments of the California Public Utilities Commission and the People of the State of California, p. 39.

³¹ Comments of the New York Department of Public Service, p. 6.

³² Comments of the Public Service Commission of the State of Missouri, p. 3.

³³ Staff of the state Corporation Commission of the State of Kansas, p. 9.

³⁴ Comments of the Public Utilities Commission of Ohio, p. 8.

IV. CONCLUSION

The data in Exhibit MNCR-2 includes data from the California PUC staff comments. Commissioner Kennedy has recently criticized the staff conclusion.³⁵ However, the data I used was not based on the staff's definition of competition, but the underlying SBC data. In fact, my approach avoids all of the flaws that Commissioner Kennedy argues against. Understanding how my approach deals with these issues provides a road map for the Commission to implement the framework outlined in the TRO, since the issue of state discretion, that so concerns Commissioner Kennedy has been taken off the table.³⁶

In the initial comments and these replies I include cable operators providing service through circuit switched telephony.³⁷ I have not excluded CLECs that serve only small business customers.³⁸ The loose definition of the product includes serving mass market customers remotely.³⁹ I have counted CLECs that achieve less than 1% market share,⁴⁰ although I do require that at least one of them does achieve that scale before the market is considered non-impaired.

I have considered VoIP and wireless and shown that they are not economic substitutes for mass market telephone service on a price basis and that the level of substitution is minuscule to date.⁴¹ I have also examined the issue of advertising markets and find that they tell little about the economic viability of facility deployment and facility-based competition.⁴²

³⁵ Letter from Susan P. Kennedy, October 18, 2004.

³⁶ Kennedy Letter, p. 2.

³⁷ Kennedy Letter, p. 2.

³⁸ Kennedy Letter, p. 3.

³⁹ Kennedy Letter, pp. 5, 7.

⁴⁰ Kennedy Letter, p. 4.

⁴¹ Kennedy Letter, p. 6.

⁴² Kennedy Letter, p. 7.

I give proper weight to the fact that over 100 switches have been deployed⁴³ and conclude that a significant number of central offices in the state are not impaired,⁴⁴ precisely those where customers are being served as a result of a significant competitive deployment of switches. The deployment of these switches while UNE-P is available undercuts the claim that UNE-P precludes investment in facilities.⁴⁵ The economic analysis provided in this proceeding, and many state proceedings, shows that investments are being made where they make economic sense.

Commissioner Kennedy offers two observations about the incentives to invest with which I disagree, however. The call for a three-year sunset on unbundling, regardless of the state of competition is inconsistent with the Act and the mandate of the court. It could leave large numbers of mass market customers with little, if any competition.

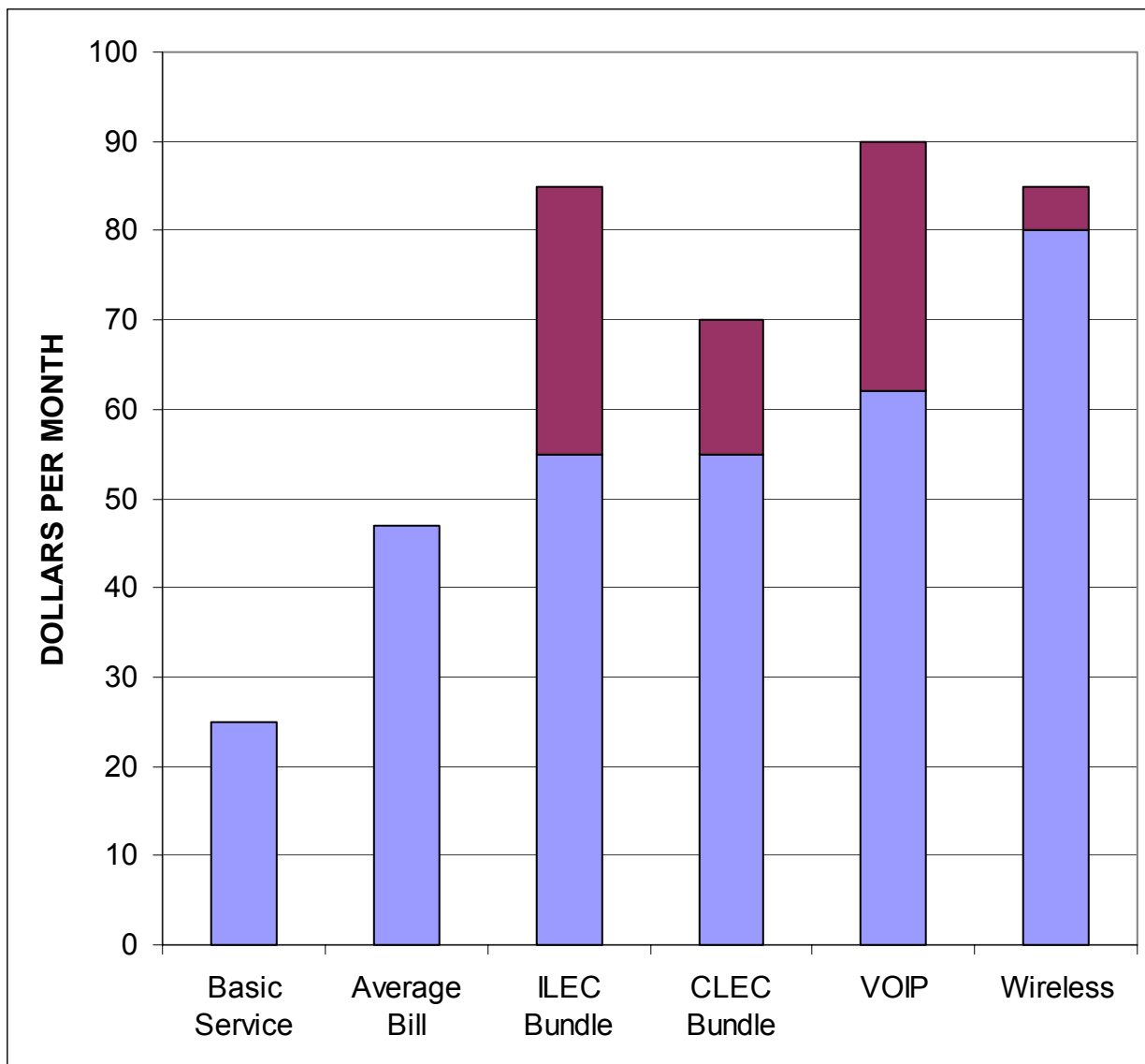
The economic analysis of switching costs and the empirical analysis of the deployment of competitive switching make it clear that the central office is the proper unit of analysis, as long as the product – market is defined broadly. The actual deployment of competitive switching reflects the large barriers to entry. Significant competitive deployment is restricted to a small set of large, high-density central offices. They should be declared non-non-impaired. The remainder is impaired.

⁴³ Kennedy Letter, p. 5.

⁴⁴ Kennedy Letter, p. 5.

⁴⁵ Kennedy Letter, p. 6.

EXHIBIT MNCR-1
MONTHLY COST OF VARIOUS SERVICES⁴⁶



⁴⁶ Source: UNE Fact Report 2004, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, In the Matter of Unbundled Access to Network Elements, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, WC Docket No. 04-313, CC Docket No. 01-338, October 2004. Federal Communications Commission, Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, 2004, p. iv.

EXHIBIT MNCR-2
COMPARISONS OF COMPETITIVE CLEC SWITCHING IN LARGE STATES

State	% Of Central Offices With No CLEC Self-Supplying Switching	% Of Central Offices With Fewer Than 3 CLECs Self-Supplying	% Of Central Offices With Five or More CLECs Self-Supplying Switching
Texas ⁴⁷	34	66	19
Ohio ⁴⁸	34	na	na
New York ⁴⁹	na	69	15
California ⁵⁰	na	58	na

⁴⁷ Statement of Dr. Mark Cooper on Behalf of the Texas Office of Public Utility Counsel and the Consumer Federation of America, Exhibit MNC-17.

⁴⁸ Comments of the Office of the Ohio Consumers' Counsel on the Notice of Proposed Rulemaking," p. 28.

⁴⁹ Comments of the New York State Department of Public Service, Attachment "Department of Public Service Staff's Analysis of Switching and Transport Triggers, March 31, 2004, Attachment 1.

⁵⁰ Comments of the California Public Utilities Commission and of the People of the State of California, p. 55.